Annual Report 2005

Ready.

K·BRO LINEN INCOME FUND

As Canada's premier provider of linen services to the healthcare and hospitality industries for over 50 years, we have established considerable expertise and infrastructure to serve our customers. On February 3, 2005, K-Bro Linen Income Fund completed its Initial Public Offering.

We are ready for the future.

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K-Bro is ready to provide our unit holders with...

Income

- Distributions of $1.05/ unit were consistently paid in 2005.
- Distributions were increased by 4.8% to $1.10/unit commencing with the January, 2006 distribution.
- Distributable cash for 2005 was $6.2 million or $1.41/unit, an increase of $2.0 million ($0.45/unit) or 32% over IPO targets.
- Revenues increased by 12.2%, volumes by 14.0% and EBITDA by 26.9% over the comparable previous period.
- Unit value of $12.75 at December 31, 2005 and $13.10 at February 17, 2006 has given the initial unitholders an annual return (including distributions received) of 37% and 41% respectively.
- K-Bro has a modest payout ratio of 68% for 2005.
- The company has a conservative debt/EBITDA ratio of 0.76 at December 31, 2005.

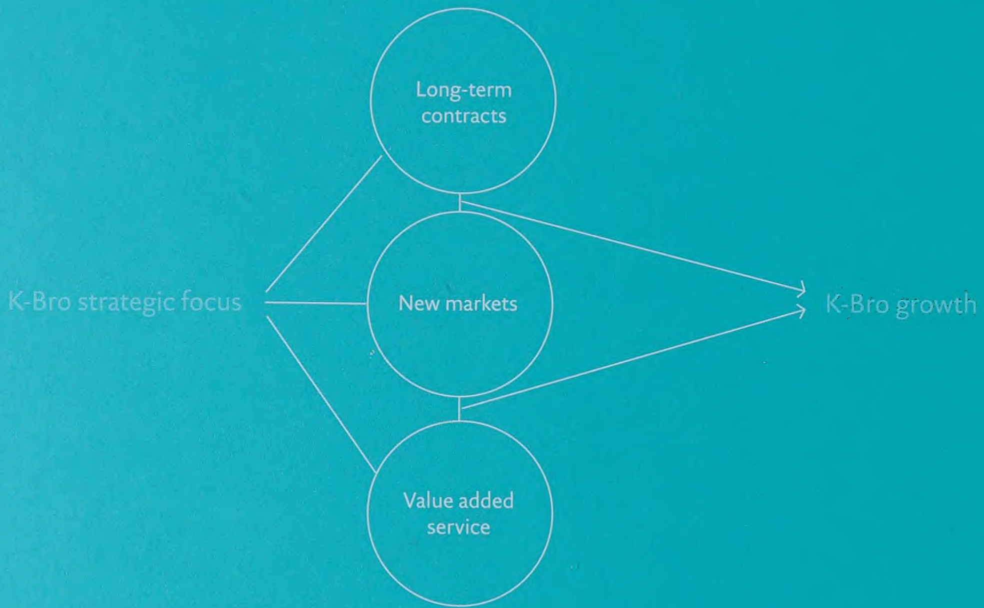
Trust

- K-Bro is Canada's largest healthcare and hospitality laundry and linen processor. Our name is known and respected in our industry.
- Healthcare is a non-cyclical essential services industry with organic growth from demographic factors.
- Our established relationships are based on contracts, such as exclusive 7-10 year hospital contracts and 2-5 year hospitality contracts.
- We have modest maintenance capital expenditure requirements and long-term EBITDA visibility from the long-term contracts as well as fixed rates on natural gas, electricity and interest.
- There are significant barriers to entry in the industry.
- We have demonstrated proven strategies for continued growth.
- Our management and operating teams have many years of experience and we have an effective organizational structure.
- Our business model is scalable and ready to grow.

($ thousands)		2005[1]		2004[1]
Operations				
Revenue	$	48,102	$	42,866
EBITDA	$	7,114	$	5,608
EBITDA as a % of revenue		14.8%		13.1%
Net earnings	$	3,452	$	1,447
Net earnings as a % of revenue		7.2%		3.4%
Per Unit				
Basic & diluted earnings per Unit	$	0.78	$	–
Distributable cash	$	1.41	$	–
Distributions	$	0.96	$	–
Payout ratio		68%		–
Financial				
Total assets	$	58,458	$	35,206
Total long term financial liabilities	$	11,740	$	12,650
Funds provided by operations	$	7,117	$	3,614
Long-term debt, end of period	$	5,401	$	10,482
Ratio of debt to EBITDA		0.76		1.87

[1] For the period February 3 to December 31.

K-Bro is ready to work towards stable growth for our unitholders by responding to opportunities from a position of strength.



To thrive in today's evolving markets, a company has to have a strategy that is responsive to evolving industry conditions and client needs and be able to rapidly identify and meet new challenges and opportunities.

Our vision for growth depends on capitalizing on the many strengths and competitive advantages we have in all areas of our business. Our strategy includes keeping a clear view of what lies ahead while maintaining a three-part strategic focus:

- to secure and maintain long-term contracts with large healthcare and hospitality customers.
- to extend core services to new markets.
- to introduce value added related services.

K-Bro Linen Income Fund (the 'Fund') completed its Initial Public Offerings of 4,343,862 Units on February 3, 2005 at a price of $10.00/unit. The Fund's 100% owned operating subsidiary is K-Bro Linen Systems Inc. ('K-Bro'). As a new Income Trust but a firmly established company, we are growth oriented and expect to prosper through our combined financial and industry experience.

Ready for the future.

Developing on all fronts with unitholders and customers in mind.

It is truly with great pleasure that I write our inaugural letter to Unitholders of K-Bro Linen Income Fund. Our first year as a public company began with our February IPO, an extremely significant event in our 50 year history that kicked-off one of our most successful years ever. We have benefited from the expansion and growth of our customers as increased demand for healthcare services and rising hotel occupancies have led to significantly more volume for us. At the same time, our increased access to capital is enabling us to make investments that further increase the gap between K-Bro and our public and private sector competitors. All told, 2005 has been a year of great success, excitement and promise for our company, our employees and our Unitholders.

I am very pleased with our initial period as a public company and we have realized strong results for our Unitholders in several ways for the period from February 3, 2005 to December 31, 2005:

- Revenue was $48.1 million, an increase of 12.2% over the same period in 2004.
- EBITDA was $7.1 million, an increase of 26.9% over the same period in 2004.
- Distributions were $1.05 annualized, resulting in a conservative payout ratio of 68%. Distributions were increased to $1.10 per unit (annualized) effective with the distribution for the month of January, 2006.
- Long-term debt was $5.4 million at year-end, a modest debt to EBITDA ratio of 0.76.
- Our unit price closed the year at $12.75, a 27.5% increase from our February IPO price of $10.00. Including distributions, a total return of 37.1% was achieved for our initial Unitholders.

While I am satisfied with our 2005 results, I am even more excited about our momentum entering 2006. Our industry is undergoing many changes and these changes present opportunities in all of our markets and throughout Canada. We have begun 2006 as we ended 2005 with several key "wins". Firstly, we have signed contracts with new healthcare and hospitality customers which we feel will positively impact our financial results for 2006. Secondly, our existing healthcare customers have announced bed openings that we expect to further add to our revenue. Thirdly, our strategic capital expenditure program, announced in October, 2005, should begin to yield positive results early in 2006. This program includes 20 million pounds of new capacity in Toronto and Vancouver. Finally, in addition to organic and new customer growth opportunities, we regularly consider acquisition opportunities in existing and new markets.

In addition to our 850 employees, my deep appreciation is extended to our customers, our Board and our Unitholders. All have played a significant role in our successful year. We are ready for the future and we very much look forward to the challenges and opportunities that lie ahead.

Linda McCurdy
President and Chief Executive Officer

Ready.

K-Bro is ready to serve customers who are leaders in healthcare and hospitality and who rely on us for quality, service and innovation.

People rely on us

For over half a century, K-Bro has been ready to serve hotels, hospitals, continuing care facilities and other institutions that rely on our services to assist them with the health and comfort of the people they serve. We don't just wash, dry and deliver linen to the customer's dock. Our commitment to service excellence includes full healthcare and hospitality linen management programs.

Hospitals depend on us to provide a reliable, comprehensive service program 365 days a year and have the ability to respond to challenges such as pandemics or disasters. Operating rooms trust our surgical packs that are used during procedures. Hotels choose our linens to provide their guests with the feeling of pampered cleanliness.

Responsive to industry

Our profile has been enhanced by our willingness to work with our customers in the healthcare and hospitality sectors to help them accomplish their goals.

K-Bro's long history and stable management strategy have resulted in us achieving a position of leadership in the linen industry and a reputation for reliability, high standards, and service excellence. In our many years in business, we've learned a lot about how to structure our company and processes in a way that allows us to address any shifts in our customers' needs. We plan on satisfying existing and new customers – and staying ahead of our competitors – through our emphasis on continuous process improvement and developing innovative solutions to challenges. Our cost-effectiveness and range of product offerings will all help us achieve this goal.

Ready.

K-Bro is ready to deliver high quality linen service programs through our excellent state of the art facilities.

Four modern plants

Superior processes and technology help us apply our expertise and deliver our comprehensive range of general and specialized linen processing, management, and distribution services. We've been able to update our equipment and processes to reflect advances in technology and industry standards.

K-Bro currently has laundry and linen processing facilities in four cities: Toronto, Edmonton, Calgary, and Vancouver. We are Canada's largest owner and operator of laundry and linen processing facilities.

Our plants are equipped with large-scale, high-capacity, efficient equipment. Operations are largely automated and we use monorail conveyance systems, sophisticated process controls and automated feeders and folders to maximize consistency and efficiency.

We have implemented a $6.4 million strategic capital expenditure program that will be fully operational in 2006 and is expected to further enhance our capacities and efficiencies.

Sophisticated process control

All of our plants meet the Health Canada standards for laundry processing and adhere to strict quality standards. Built-in redundant capacity ensures that we are capable of providing a continuity of service 365 days a year. An ongoing preventative maintenance program administered by specially trained employees ensures the maximum uptime for our equipment.

Our customers can expect us to be able to keep up with increases in their volume or with tight timelines for delivery because our technological resources and continual quest for process improvement make us a highly responsive company in our industry. With four major plants, we can share our successes and implement best practices in all of our facilities.

Ready.

K-Bro is ready to grow by identifying and moving into new markets and filling existing market gaps.

Pursuing opportunities

The key to long-term success is the ability to not just to see all possibilities but also to be ready to act on that vision. Our wealth of experience and resources has given us a secure foundation to build on and we are using that as our springboard for growth. When you have your house in order, you can respond swiftly and surely to opportunities and challenges.

Currently, approximately 81% of our revenue comes from our healthcare customers, with the remaining 19% from the hospitality and commercial sectors. Although we already hold a significant market share in our existing service areas, there is room to grow, not only by expanding our geographic reach but also through the introduction of new product offerings. Demographic changes positively impact our industry too – an aging population requiring more healthcare services – and we are poised to take advantage of the opportunities in the market these factors create.

A bright outlook

We've already announced some exciting growth stories for 2006 and we are optimistic we will be able to announce even more as the year progresses. We are ready to grow with experienced operational management in place and with financial capacity available from the public and private markets.

Working towards expansion from a position of strength, with solid leadership and customer-focused expertise, we are ready for the future.

Management's Discussion and Analysis

February 3, 2005 to December 31, 2005

The following management's discussion and analysis is supplemental to, and should be read in conjunction with, the audited consolidated financial statements of K-Bro Linen Income Fund ("the Fund") for the period from February 3, 2005 to December 31, 2005. These financial statements can be found on SEDAR at www.sedar.com. The Fund's financial statements are prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). The Fund's reporting currency is the Canadian dollar.

Management is responsible for the information contained in the Management's Discussion and Analysis and its consistency with information presented to the Audit Committee and Board of Trustees. All information in this document has been reviewed and approved by the Audit Committee and Board of Trustees. This review was performed by Management with information available as of March 2, 2006. As of December 31, 2005, an evaluation was carried out, under the supervision of and with the participation of management, including the President and Chief Executive Officer and the Vice President and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures as defined in Multilateral Instrument 52-109. Based on that evaluation, the President and Chief Executive Officer and the Vice President and Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective.

This discussion contains forward looking statements. Please see note regarding "Forward Looking Statements" for a discussion of the risks, uncertainties and assumptions relating to these statements. This discussion also makes reference to certain non-GAAP measures to assist in assessing the Fund's financial performance. Non-GAAP measures do not have any standard meaning prescribed by GAAP and are therefore unlikely to be comparable to similar measures presented by other issuers.

Overview

CORE BUSINESS

The Fund is a limited purpose trust established under the laws of Alberta pursuant to the Amended and Restated Fund Declaration of Trust dated February 3, 2005. The Fund was created for the purpose of acquiring, directly or indirectly, all of the issued and outstanding securities of K-Bro Linen Systems Inc.

K-Bro Linen Systems Inc. is the largest owner and operator of laundry and linen processing facilities in Canada. K-Bro provides a comprehensive range of general linen and operating room linen processing, management and distribution services to healthcare institutions, hotels and other commercial accounts. K-Bro currently owns and operates processing facilities from leased premises in four of Canada's largest cities: Toronto, Edmonton, Calgary and Vancouver. The Fund and its subsidiary will collectively be referred to as "K-Bro" in this Management's Discussion and Analysis.

INDUSTRY AND MARKET

K-Bro provides laundry and linen services to Canadian healthcare, hospitality and other commercial customers. Typical services offered by K-Bro include the processing, management and distribution of general and operating room linens, including sheets, blankets, towels, tablecloths, surgical gowns and drapes and other linen. Other types of processors in K-Bro's industry in Canada include independent privately owned facilities (i.e., typically, small single facility companies), public sector central laundries and public and private sector on-premise laundries (known as OPLs). Participants in other segments of the laundry and linen services industry, such as uniform rental companies (which own and launder uniforms worn by their customers' employees) and facilities management companies (which manage public sector central laundries and OPLs), typically do not offer services that significantly overlap with those offered by K-Bro.

While recognized industry statistics are not available, management estimates that the size of the market for services offered by the Company to the healthcare and hospitality segments of the Canadian laundry and linen services industry is between $720 million and $880 million, including between $530 million and $630 million of revenue derived from the healthcare segment and between $190 million and $250 million derived from the hospitality segment.

Management believes that the healthcare and hospitality segments of the laundry and linen services industry represent a stable base of annual recurring business with opportunities for growth as additional healthcare beds and funds are made available to meet the needs of an aging demographic.

Linen processing requirements in the hospitality segment are, to a significant extent, related to the number of hotel rooms and room occupancy rates. The number of hotel rooms across Canada and their occupancy rates have remained relatively consistent during the past five years.

INDUSTRY CHARACTERISTICS AND TRENDS

Management believes that the healthcare and hospitality segments of Canada's linen services industry exhibit the following primary characteristics and trends:

Stable industry with moderate cyclicality

Management believes that the linen processing requirements of healthcare and hospitality institutions are generally stable as evidenced by the stability in the number of approved hospital beds in the healthcare system and hotel rooms. In addition, a characteristic of the industry is that service relationships are typically formalized through contracts. Contracts in the healthcare segment are typically long term (up to 10 years), while contracts in the hospitality segment typically range from two to five years. In general, customer turnover rates are low.

The healthcare segment of the laundry and linen services industry exhibits moderate seasonality as usage falls during holiday seasons. Linen processing volumes in the hospitality segment exhibit more seasonality compared with the healthcare segment as usage increases in the summer months.

Significant barriers to entry

There are significant barriers to entry for new entrants to the healthcare and hospitality segments of Canada's laundry and linen services industry. In general, establishing new laundry facilities involves significant up front investment in equipment, facilities and labour. Companies that attempt to enter the healthcare segment face additional barriers to entry, even if they have existing laundry facilities, as they are typically required to make a significant up-front cash investment in linen (and, if necessary, specialized equipment) for new healthcare accounts. In addition, customer contracts are typically long term, making it more difficult for new entrants to access new accounts other than upon the expiry of a contract's term.

There are fewer barriers to entry for companies seeking to service the linen processing requirements of hospitality customers (e.g. customers own their linens and less specialized equipment can often be used), although new entrants are still confronted by such barriers as the need for up-front investment in equipment, facilities and labour.

Outsourcing and privatization

Healthcare institutions in many large Canadian cities currently process all of, or a portion of, their linens through public sector central laundries or OPLs located within public sector facilities. Management believes that there are often advantages to healthcare institutions in outsourcing the processing of healthcare linen to private sector laundry companies such as K-Bro. Management believes that larger private sector companies such as K-Bro that have economies of scale and significant management expertise can provide laundry and linen services on a more comprehensive and cost-effective basis than customers can achieve in operating their own laundry facilities. In recent years, healthcare institutions in Vancouver, Calgary, Edmonton and, to a lesser extent, Southern Ontario have elected to outsource their linen processing requirements. As the largest provider of laundry and linen services to healthcare and hospitality customers in Canada, K-Bro believes that it is well-positioned to capitalize on any further outsourcing of volume.

Fragmentation

Most Canadian cities have at least one and sometimes several private sector competitors operating in the healthcare and hospitality segments of the laundry and linen services industry. Management believes that the presence of these operators provides acquisition and consolidation opportunities for larger industry participants with the financial means to complete acquisitions.

CUSTOMERS AND PRODUCT MIX

K-Bro's customers include some of the largest healthcare and hospitality institutions in Canada. Healthcare customers include hospitals and long-term care facilities. Most of K-Bro's hospitality customers (typically 250+ rooms) generate between 500,000 and 3,000,000 pounds of linen per year. Most healthcare customers generate between 500,000 pounds of linen per year for a hospital up to 20,000,000 pounds of linen per year for a healthcare region.

The relative revenue contributions from K-Bro's healthcare and hospitality customers is approximately 83.5% and 16.5% respectively at December 31, 2005.

Vision

Management believes that K-Bro can grow in existing and new markets by capitalizing on its strengths and competitive advantages which include:

Long-term contracts

K-Bro's contracts with its healthcare customers typically range from seven to ten years. Contracts in the hospitality segment typically range from two to five years. Approximately 47% of K-Bro's current revenues are under contract until December 2010 or later, and customers representing approximately 80% of current revenues are under contract until 2008 or later. K-Bro is the exclusive provider of laundry and linen services to most of its customers. These long standing relationships, customer knowledge, quality services and value added services may bode well when contract renewals are due.

Strong institutional customer base

K-Bro's customers include a number of leading hospitals, health authorities, continuing care facilities and hotels in Canada. Healthcare customers include Calgary Health Region (the central healthcare organization in Calgary), The Hospital For Sick Children in Toronto, Vancouver Coastal Health (the central healthcare organization for the Vancouver region) and Capital Health (the central healthcare organization for the Edmonton region). K-Bro's hospitality customers include Fairmont Hotel Macdonald in Edmonton, The Hyatt Regency in Calgary and The Sheraton Centre in Toronto. This customer base provides a strong reference list for entry into new markets or expanding services in existing markets.

Modest maintenance capital expenditure requirements

Laundry equipment can, with proper ongoing maintenance, remain operative for long periods of time. For example, the useful life of a high capacity, energy efficient tunnel washer can extend beyond 20 years. This allows for competitive pricing for existing and new customers, as well as margin improvement as additional volumes are processed without additional capital expenditure. The longevity of equipment is enhanced by having a full complement of qualified maintenance engineers at each plant performing a comprehensive on-going preventative maintenance program.

National brand-name recognition and strong reputation

K-Bro is the largest owner and operator of laundry and linen processing plants in Canada and the only service provider with a large operation in several of Canada's largest cities. Management believes that K-Bro's size and presence in multiple markets provide it with enhanced credibility when competing for new accounts in existing markets. As well, opportunity for growth in new markets through acquisitions or new builds is also enhanced.

Experienced management team and effective organizational structure

The general managers at K-Bro's four laundry facilities have each been with K-Bro from 13 to 19 years, and all began their careers at K-Bro in other positions before being promoted to their current offices. K-Bro's Chief Executive Officer has been with the Company for more than seven years, and has served in this capacity for the past six years. The Chief Financial Officer was previously with K-Bro for six years, lastly as President, and returned to K-Bro on June 1, 2005. The Company's organizational structure has been developed to enable the general managers of the Company's plants to focus on growth and operations in their individual markets, while enabling aggressive business development and tight management controls through K-Bro's separate corporate team.

Scalable business model

Each of K-Bro's plants is highly automated and has a cost structure with a significant fixed cost component. This allows the Company to generate economies of scale as volumes increase. K-Bro's plants have the ability to further increase capacity by adding equipment and/or, where appropriate, extending operating hours.

Strategy

K-Bro maintains the following three-part strategic focus:

Secure and maintain long-term contracts with large healthcare and hospitality customers

K-Bro's core service is providing high quality laundry and linen services at competitive prices to large healthcare and hospitality customers under long-term contracts. K-Bro's contracts in the healthcare segment typically range from seven to ten years in length. Contracts in the hospitality segment typically range from two to five years. Management estimates that K Bro's market share of healthcare and hospitality volumes in Edmonton, Calgary, Vancouver and Toronto is 70%, 50%, 22% and 12%, respectively. While some of the remaining healthcare and hospitality volumes may not be pursued by K Bro, management believes that the Company has the potential to increase volumes in the Company's existing markets.

Extend core services to new markets

Management has demonstrated its ability to successfully expand K-Bro's business into new markets. K-Bro entered the Calgary market in 1998 and the Vancouver market in 2003. These new markets have contributed significantly to the Company's growth. Management believes that new outsourcing opportunities will continue to arise in the near to medium term and that K-Bro is well-positioned for continued growth, particularly as healthcare and hospitality institutions continue to increase their focus on core services and confront pressures for capital and cost savings.

Management may in the future expand its core services to new markets either through acquisitions or by establishing new facilities. Its choice of areas for expansion will depend on the availability of suitable acquisition candidates, the volume of healthcare linen to be processed and the policies of provincial governments.

Introduce related services

In addition to focusing on its core services, K-Bro also attempts to capitalize on attractive business opportunities by introducing closely related services that enable it to provide more complete solutions to the Company's healthcare customers. These related service offerings include K-Bro Operating Room Services ("KOR") and on-site services. For example, with the commencement of the Mount Sinai Hospital contract (see "Recent Developments"), K-Bro will be introducing sterilization of operating room linen packs to its menu of services.

Recent developments

DISTRIBUTIONS INCREASED

On January 23, 2006 K-Bro announced an increase in its monthly distribution by $0.00417 per unit from $0.08750 to $0.09167 (or from $1.05 per unit to $1.10 per unit on an annualized basis). This represents a 4.8% increase and is the result of continued strong performance of the current business.

TONY CLEMENT APPOINTED MINISTER OF HEALTH

On February 6, 2006 Tony Clement tendered his resignation as a Trustee of K-Bro as a result of his appointment to Cabinet as Minister of Health.

GROWTH ACHIEVED

Volumes processed to December 31, 2005 were approximately 14% higher than 2004 (10% higher for the fourth quarter). Much of this growth has come from existing healthcare customers as a result of additional beds being opened, increased usage of existing beds and increased usage of certain items such as precautionary gowns. In addition, K-Bro has secured 25 net new clients/sites in the last 12 months with annualized volumes of approximately 11 million pounds. Of this annualized 11 million pound increase, 5 million pounds were acquired from a competitor through bankruptcy proceedings in October 2004 for total consideration of $367,000 which included certain equipment.

K-Bro has also announced the signing of new customers to contracts in Toronto (Mount Sinai Hospital and Westin Harbour Castle hotel) and in Calgary (Fairmont Palliser hotel, Delta Calgary Airport hotel and the Delta Lodge at Kananaskis), all to commence in the first quarter of 2006. Annual incremental revenue from these new signings is estimated at $3.3 million.

CAPACITY AND EFFICIENCIES INCREASED

On October 17, 2005 K-Bro announced a $6.4 million strategic capital expenditure program that once operational is expected to be immediately accretive from labor and throughput efficiencies as well as provide a total of 25 million pounds of additional capacity in the Toronto and Vancouver operations. These expenditures are expected to occur over a period from approximately December 1, 2005 to March 31, 2006. At December 31, 2005 deposits of $1.4 million had been made on these purchases.

NEAR TERM BUSINESS DEVELOPMENT OPPORTUNITIES

K-Bro currently has proposals out and has entered into discussions with potential new healthcare and hospitality customers. In addition, discussions are at various stages with potential acquisition candidates. The degree of likelihood of success with any of these proposals or potential acquisitions cannot be stated with any degree of accuracy at this time.

LONGER TERM BUSINESS DEVELOPMENT OPPORTUNITIES

In Edmonton, Capital Health has announced receipt of $647 million from the Government of Alberta to pursue part of its 10-year capital plan, including the construction of new facilities and the renovation and expansion of existing facilities. With this funding, Capital Health will proceed with 10 construction projects that will add an additional 455 beds to the region, bringing the region one step closer to its goal of increasing the acute care bed ratio to 1.9/1000 population from 1.6/1000. The Calgary Health Region announced receipt of $662 million from the Government of Alberta that will go towards completing several major projects that will increase the number of beds by approximately 525. In addition, the new Alberta Children's Hospital is scheduled to open in the fall of 2006.

GOVERNMENT REVIEW OF FLOW THROUGH ENTITY ("FTE") TAX ISSUES

On November 23, 2005 the former Finance Minister Ralph Goodale issued a press release ending the government's consultations on income trusts and instead proposed to reduce the personal tax payable on dividends from public corporations. A change in government in January, 2006 has put any changes in abeyance. There was no announcement of any tax to be levied on income funds.

Results of operations (all amounts in $000's except per unit amounts)

OVERALL PERFORMANCE

The results of operations in the following discussion include the consolidated results of K-Bro for the period since the Fund completed the acquisition of K-Bro Linen Systems Inc. on February 3, 2005 with the completion of a public offering.

Since this is the first reporting period for the Fund, there are no comparative figures representing the operations of the Fund in prior periods in the consolidated financial statements of the Fund. However, selected comparative figures for the period February 3, 2004 to December 31, 2004 have been presented in this MD&A representing K-Bro's underlying business for that period consisting of K-Bro Holdco Inc. and its wholly-owned subsidiaries K-Bro Linen Systems Inc. ("K-Bro"), 766429 Alberta Ltd. and K-Bro Linen Systems (Ontario) Limited. For the period from February 3, 2004 to December 31, 2004, estimates and pro-rations are based on management's estimate of the appropriate amounts to be included in the period.

The acquisition by the Fund of K-Bro Linen Systems Inc. was accounted for using the purchase method of accounting. Purchase accounting resulted in the adjustment of certain assets and liabilities to their fair market values. These valuation adjustments have no impact on the cash position or cash flow generated by K-Bro and therefore have no impact on the ability of K-Bro to distribute cash to unitholders of the Fund.

The fourth quarter of 2005 was again very successful with revenue increasing by $1,463 over 2004 or 12.1%. Year to date revenue for 2005 has increased by $5,236 over 2004 or 12.2%. These revenue increases were the result of additional volume in all operations. Healthcare customer volume increased by 9.0% in the quarter and 6.9% year to date from 2004 due to an increase in beds as well as the increased use of certain items such as isolation gowns for infection control purposes. Hospitality volume increased by 12.8% in the quarter and 35.6% year to date from 2004 mainly from the addition of volume in Vancouver acquired from a competitor through bankruptcy proceedings in the fourth quarter of 2004 but also from new accounts in other operations. Price increases to healthcare customers of 1.6% over 2004 for the quarter and 1.3% over 2004 year to date were also realized which contributed positively to the results.

EBITDA increased by $671 (51.6%) for the quarter and $1,506 (26.9%) year to date over 2004 as a result of this additional volume and cost savings achieved.

SELECTED ANNUAL AND QUARTERLY FINANCIAL INFORMATION (UNAUDITED) ($000'S)

The following table provides certain selected consolidated financial and operating data prepared by K-Bro management for the periods indicated:

Fiscal year 2005

	Total[1]	Q4	Q3	Q2	Q1[2]
Revenue	48,102	13,531	13,204	13,061	8,306
Operating expenses	40,988	11,560	11,290	11,015	7,123
EBITDA[3]	7,114	1,971	1,914	2,046	1,183
EBITDA as a % of revenue	14.8%	14.6%	14.5%	15.7%	14.2%
Amortization	3,659	994	967	1,017	681
Finance costs	360	92	83	79	106
Gain on disposal of equipment	64	–	4	60	–
Earnings before income taxes	3,159	885	868	1,010	396
Income tax (recovery)	(293)	(93)	(111)	(9)	(80)
Net earnings	3,452	978	979	1,019	476
Net earnings as a % of revenue	7.2%	7.2%	7.4%	7.8%	5.7%
Basic & diluted earnings per unit	0.78	0.22	0.22	0.23	0.11
Total assets	58,458	58,458	57,206	56,748	58,332
Total long term financial liabilities	11,740	11,740	11,614	11,582	11,775
Funds provided (used) by operations	7,117	3,011	1,067	839	2,200
Long-term debt, end of period	5,401	5,401	5,280	5,147	5,247

Fiscal year 2004

	Total[1]	Q4	Q3	Q2	Q1[2]
Revenue	42,866	12,068	11,569	11,571	7,658
Operating expenses	37,258	10,768	10,025	9,856	6,609
EBITDA[3]	5,608	1,300	1,544	1,715	1,049
EBITDA as a % of revenue	13.1%	10.8%	13.3%	14.8%	13.7%
Amortization	2,707	745	722	761	479
Finance costs	983	255	265	273	190
Gain on disposal of equipment	–	–	–	–	–
Earnings before income taxes	1,918	300	557	681	380
Income tax (recovery)	875	(202)	244	259	170
Net earnings	1,447	502	313	422	210
Net earnings as a % of revenue	3.4%	4.2%	2.7%	3.6%	2.7%
Basic & diluted earnings per unit	–	–	–	–	–
Total assets	35,206	35,206	37,602	36,294	36,163
Total long term financial liabilities	12,650	12,650	15,905	14,851	13,705
Funds provided (used) by operations	3,614	2,472	2,291	(357)	(792)
Long-term debt, end of period	10,482	10,482	13,732	12,901	13,643

[1] For the period February 3 to December 31.

[2] For the period February 3 to March 31.

[3] EBITDA is defined as revenue less operating expenses as reflected in the table above. EBITDA is not an earnings measure recognized by GAAP and has no standardized meaning prescribed by GAAP. Therefore, EBITDA may not be comparable to similar measures presented by other issuers.

Revenues

Revenues by sector consist of:

2005

		Total[1]		Q4		Q3		Q2		Q1[2]
Sector										
Healthcare	$	40,145	$	11,413	$	10,761	$	10,954	$	7,017
Hospitality		7,957		2,118		2,443		2,107		1,289
Total	$	48,102	$	13,531	$	13,204	$	13,061	$	8,306

2004

		Total[1]		Q4		Q3		Q2		Q1[2]
Sector										
Healthcare	$	37,049	$	10,313	$	10,004	$	10,037	$	6,695
Hospitality		5,817		1,755		1,565		1,534		963
Total	$	42,866	$	12,068	$	11,569	$	11,571	$	7,658

for the period February 3 to December 31.

[2] for the period February 3 to March 31.

The change in mix from Q4 2004 to Q4 2005 is reflective of the addition of hospitality accounts.

Operating expenses

Compared to 2004, operating expenses for the fourth quarter increased by $792 (7.4%) and year to date by $3,730 (10.0%). However, as a percentage of revenue, operating expenses decreased by 3.8% in the quarter and 1.7% year to date compared to 2004. This dollar increase is attributable to the 10% increase in volume processed in the quarter (14% for the fiscal year) while the decrease as a percentage of revenue is attributable to cost efficiencies and positive utility rate variances achieved in the operations. The major contributors to this positive variance were: the fixed rate natural gas purchase contracts entered into in the first quarter of 2005; a one month earlier start to the Alberta natural gas rebate program (in October in 2005 vs. November in 2004); a new lower rate chemical purchase contract; and, repairs and maintenance expenditures decreased as a result of the disposal of a warehouse in late 2004 and the resulting elimination of the repairs and maintenance operating costs associated with its operation. Delivery costs increased as a result of much higher fuel costs as well as an increase in the contracted delivery rates in Vancouver.

Compared to the third quarter, operating expenses in the current quarter increased by $270 but decreased by 0.1% of revenue. This increase is largely the result of an increase in utility rates. The impact of large increases in natural gas costs was substantially negated by the long term natural gas fixed rate contracts entered into early in 2005.

Included in Operating costs is an accrual of $418 year to date and $126 for the quarter (nil in 2004 for both periods) for the estimated amount earned under the Fund's Long-term Incentive Plan.

Amortization of property and equipment

Amortization of property and equipment represents the expense related to the appropriate matching of certain of K-Bro's long-term assets to the estimated useful life and period of economic benefit to K-Bro of those assets. Linen amortization expense is included in operating expenses and is accounted for in EBITDA. Amortization of plant and equipment for the quarter decreased by $190 and year to date by $658 compared to 2004. Most of this decrease is related to the start-up costs of the Vancouver operation which were being amortized over 36 months. In 2005, as a result of the public offering, these deferred charges were written off as part of the purchase price allocation. Consequently, there is no expense for this asset for the period from February 3, 2005 to December 31, 2005.

The cost basis of Property and Equipment presented in the financial statements is the fair value upon acquisition of K-Bro in accordance with GAAP. On an historical cost basis, the cost and accumulated amortization at December 31, 2005 is as follows:

	Cost	Accumulated amortization	Net
Equipment			
Laundry	$ 22,643	$ 12,034	$ 10,609
Office	495	336	159
Delivery	939	767	172
Computers and software	2,213	1,716	497
Leasehold improvements	4,586	1,942	2,644
Deposits on equipment purchases	1,438	–	1,438
	32,314	16,795	15,519

Future additions by way of business acquisitions, if any, will be reflected in the above table at their fair value upon acquisition.

Amortization of intangible assets

Amortization of intangible assets represents the expense related with matching K-Bro's intangible assets to the estimated useful life and period of economic benefit to K-Bro of those assets. As part of the valuation completed for purposes of the purchase price allocation, total intangible assets were recognized on the opening balance sheet of K-Bro in the amount of $19,900, representing the value attributable to various contracts held by K-Bro. Consequently, amortization for the quarter increased by $439 and year to date by $1,610 compared to the same periods in 2004.

Finance costs

Finance costs represents interest expense incurred by K-Bro as well as, in 2004, financing fees incurred with respect to banking facilities that were deferred and written off over the life of the credit agreement. Finance costs decreased by $163 for the quarter and $623 year to date compared to 2004 as a result of lower debt levels associated with the proceeds used to pay down debt from the sale leaseback transaction completed in K-Bro's Edmonton facility in late 2004 and a debt pay down of $3,100 from the pubic offering proceeds.

Income tax expense

Income tax expense includes current and future income taxes based on taxable income and the temporary timing differences between the tax and accounting bases of assets and liabilities. Income tax expense has decreased for the quarter and year to date due to the change in structure to an Income Fund whereby the Fund's unit holders bear the tax obligations with respect to distributions.

Liquidity and capital resources ($000'S)

Cash flow from operations

K-Bro generated funds from operations of $3,011 for the quarter and $7,117 year to date in 2005, an increase of $539 for the quarter and an increase of $3,503 year to date compared to 2004. This year to date increase is primarily attributable to increased EBITDA, lower finance costs and a lower working capital requirement associated with the timing of accounts receivable collections and the payment of payables. The increase for the quarter is the result of an increase in EBITDA and accounts payable associated with the timing of payments.

At December 31, 2005, working capital was $3,190, an increase of $893 from December 31, 2004. The primary reason for the change is the elimination of the current portion of long-term debt, partially offset by an increase in the distribution payable to unitholders.

Financing activities

On February 3, 2005, through an initial public offering, the Fund raised proceeds (net of offering costs and cash acquired) of $37,663 and acquired all of the issued and outstanding shares of K-Bro Linen Systems Inc.

During the period from February 3, 2005 to December 31, 2005, K-Bro declared distributions to unit holders in the amount of $4,223, of which $386 was paid subsequent to December 31, 2005 resulting in a net payment during the period of $3,837.

Long-term debt at December 31, 2005 was $5,401, compared with $10,482 at December 31, 2004. The decrease relates to a pay down of $3,100 from the proceeds generated from the public offering upon closing of the transaction as well as the cashflow generated from operations.

The existing long-term debt of $5,401 consists of draw downs on a secured revolving, interest only, credit facility of up to $12,000. The facility was a two year committed facility maturing February 3, 2007 but extendable annually for another year at the lender's option. This extension to February 3, 2008 has been received. On June 24, 2005 K-Bro entered into an interest rate swap arrangement whereby the interest rate paid on a notional amount of $4,000 of this debt has been fixed at 5.95% for a period of five years. The floating rate of interest that was swapped for this fixed rate is currently at 5.33%.

Investing activities

During the period from February 3, 2005 to December 31, 2005, K-Bro used $589 of funds for maintenance capital expenditures, $619 for strategic capital expenditures and $1,437 for deposits on equipment purchases for a total investment of $2,645. Management defines maintenance capital expenditures as additions to, or replacements of, property and equipment to maintain K-Bro's current business operations. Management estimates that ongoing annual maintenance capital expenditures are approximately $700. The modest level of maintenance capital expenditures is due to the long life of the majority of the processing equipment.

Expenditures on wear parts such as motors, belts, ironer pads, etc. are expensed as incurred. These expenditures, in addition to an extensive preventative maintenance program performed at each plant by a full complement of qualified maintenance engineers, has resulted in a repairs and maintenance expense (including personnel costs) totaling $2,775 in fiscal 2005 ($2,660 in 2004) which are included in the calculation of EBITDA.

Strategic capital expenditures are defined by management as those expenditures utilized for improvements to, and expansion of, K-Bro's property and equipment to enhance efficiencies and capacity to process incremental volumes. The strategic capital expenditures in 2005 are related to the requirements of handling the 14% increase in volume (additional tubs and carts) as well as the addition of certain efficiency enhancing finishing equipment (feeders and folders).

Contractual obligations

At December 31, 2005, payments due under contractual obligations for the next five years and thereafter are as follows:

	Payments Due by Period ($000's)				
	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
Operating leases and utility commitments	18,023	3,906	7,013	4,400	2,704
Linen purchase obligations	3,228	3,228	–	–	–
Equipment purchase commitments	4,238	4,238	–	–	–

The source of funds for these commitments will be from operating cash flow and the undrawn portion of the revolving credit facility.

Distributions for the period

For the period ended December 31, 2005, the Fund met all distribution targets. The details of the distributions are as follows:

Period	Payment Date	Per Unit Distribution	Distribution Amount
Fund Units			
February 3 to February 28, 2005	March 15, 2005	$ 0.08125	$ 352,940
March, 2005	April 15, 2005	$ 0.0875	$ 380,088
April, 2005	May 15, 2005	$ 0.0875	$ 380,088
May, 2005	June 15, 2005	$ 0.0875	$ 380,088
June, 2005	July 15, 2005	$ 0.0875	$ 380,088
July, 2005	August 15, 2005	$ 0.0875	$ 380,088
August, 2005	September 15, 2005	$ 0.0875	$ 380,088
September, 2005	October 15, 2005	$ 0.0875	$ 380,088
October, 2005	November 15, 2005	$ 0.0875	$ 380,088
November, 2005	December 15, 2005	$ 0.0875	$ 380,088
December, 2005	January 15, 2006	$ 0.0875	$ 380,088
Exchangeable Shares			
February 3 to February 28, 2005	March 15, 2005	$ 0.08125	$ 5,882
March, 2005	April 15, 2005	$ 0.0875	$ 6,336
April, 2005	May 15, 2005	$ 0.0875	$ 6,336
May, 2005	June 15, 2005	$ 0.0875	$ 6,336
June, 2005	July 15, 2005	$ 0.0875	$ 6,336
July, 2005	August 15, 2005	$ 0.0875	$ 6,336
August, 2005	September 15, 2005	$ 0.0875	$ 6,336
September, 2005	October 15, 2005	$ 0.0875	$ 6,336
October, 2005	November 15, 2005	$ 0.0875	$ 6,336
November, 2005	December 15, 2005	$ 0.0875	$ 6,336
December, 2005	January 15, 2006	$ 0.0875	$ 6,336
Total Distributions			**$ 4,223,062**

For the period ended December 31, 2005, the Fund distributed its target of $0.95625 per unit ($1.05 per unit on an annualized basis) compared with Distributable Cash per unit of $1.41045 generated as calculated below. The actual payout ratio was 68%. The difference of $0.45420 per unit reflects the strength of earnings for the period from February 3, 2005 to December 31, 2005 compared to the original projection.

Cash available for distributions

		Period from February 3 to December 31, 2005
Per audited consolidated financial statements:		
Cash provided by operating activities	$	7,117,243
Net changes in non-cash working capital items		(363,136)
Finance costs		359,798
EBITDA		7,113,905
Add (deduct):		
Finance costs		(359,798)
Maintenance capital		(588,642)
Cash taxes		–
Gain on disposal of fixed assets		63,477
Cash Available for Distributions	$	**6,228,942**
Cash Available for Distributions per Unit	$	**1.41**
Distributions Declared	$	4,223,062
Distributions Declared per Unit	$	**0.96**
Payout Ratio		**68%**
Weighted Average Units Outstanding During the Period		4,416,273

Outstanding share units

At December 31, 2005, K-Bro had 4,343,862 Fund Units outstanding and 72,411 Exchangeable Shares outstanding.

Critical accounting estimates

The preparation of the financial statements, in conformity with Canadian generally accepted accounting principles, requires management of K-Bro to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

Linen in Service

Linen in service is recorded at cost. Operating room linen is amortized on a straight-line method over an estimated service life of 24 months. General linen is amortized based on usage which results in an estimated service life of the linen equal to 24 months. Based on past experience, management believes that a service life of 24 months is representative of the average service life of linen and would not expect a material deviation.

Revenue and Volume Rebates

Revenue from linen management and laundry services is largely based on written service agreements, whereby K-Bro has agreed to collect, launder, deliver and replenish linens. K-Bro recognizes revenue in the period in which the services are provided. Volume rebates, where applicable, are recorded based on annualized expected volumes when it is determined that they are likely to be met.

Property and equipment

Property and equipment are recorded at cost. Amortization is provided over the useful lives of the assets on a declining basis using the following annual rates:

Laundry equipment	15%
Office and delivery equipment	20%
Computers and software	30%
Leasehold improvements	straight line over the lease period

The carrying value of property and equipment is evaluated whenever significant circumstances indicate impairment in value.

Goodwill

K-Bro assesses goodwill for impairment on an annual basis, or more frequently if changes in circumstances indicate a potential impairment. Any resulting impairment is charged to earnings in the period in which the impairment is identified. No impairment was incurred upon completion of the 2005 assessment by management.

Intangible assets

Intangible assets with a finite life which relate to contracts the Fund has with certain customers are recorded at cost and are amortized over the remaining life of the contract plus one renewal period, ranging from 49 to 205 remaining months. Impairment is evaluated if there are significant changes in circumstances affecting the carrying value of intangible assets. Management has determined that no such significant change has occurred in 2005.

Changes in accounting policies including initial adoption

Effective February 3, 2005, K-Bro adopted the new accounting policy of Section 3110 of the Canadian Institute of Chartered Accountants ("CICA") Handbook for Asset Retirement Obligations and has determined that, as at December 31, 2005, no adjustment is required to recognize liabilities of this nature.

Effective February 3, 2005, K-Bro adopted the recommendations of Section 3063 of the CICA Handbook "Impairment of Long lived Assets". The Handbook requires the recognition of an impairment loss for a long lived asset when events cause its carrying value to exceed the total undiscounted cash flows expected from its use and eventual disposition. The adoption of this Handbook Section had no impact on K-Bro.

Financial instruments and other instruments

a) **Financial instruments**

The Fund's financial instruments consists of derivative financial instruments, distributions payable, accounts receivable, accounts payable and accrued liabilities and long-term debt. Unless otherwise stated, the fair value of the financial instruments approximates their carrying value.

b) Derivative financial instruments

The Fund has adopted CICA Accounting Guideline 13, Hedging Relationships. This pronouncement establishes the criteria that must be met before an entity can apply hedge accounting to certain derivative financial instruments.

Derivative financial instruments are utilized by the Fund to manage cashflow risk against the volatility in interest rates on its long-term debt. The Fund does not utilize derivative financial instruments for trading or speculative purposes.

The Fund has floating interest rate debt that gives rise to risks that its earnings and cash flows may be adversely impacted by fluctuations in interest rates. In order to manage this risk, the Fund may enter into interest rate swaps, forward contracts or option contracts.

It is the Fund's policy to document all relationships between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedge transactions. This process includes linking all derivatives to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. The Fund also assesses, both at the hedge inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are effective in offsetting changes in fair value or cash flows of hedged items. The Fund's interest rate swaps, forward contracts or option contracts are designated as hedges when the underlying risks of the hedged and hedging instruments offset to manage the Fund's exposure. Gains or losses relating to such contracts are deferred and recognized in the same period and financial statement category as the corresponding hedge transactions. If contracts cease to be effective as hedges prior to maturity or if the hedge relationship is terminated, any cumulative gains or losses arising prior to such time will be deferred over the period of the original hedged transaction and subsequent changes in fair value of the derivative contracts are recognized as adjustments to income.

Outlook

Management continues to pursue new opportunities in existing and new markets. New contracts have recently been announced as noted under "Recent Developments" that are expected to be accretive. Also as noted, the $6.4 million strategic capital expenditure program is expected to be accretive when fully operational.

With this announced new volume, expected organic growth from existing customers and the anticipated accretiveness of the strategic capital expenditure program, management believes that incremental growth in revenue and EBITDA will again occur in 2006.

Forward-looking statements

In the interest of providing unitholders and potential investors of K-Bro with information regarding future plans and operations, this Management's Discussion and Analysis ("MD&A") contains forward-looking information that represents internal expectations, estimates or beliefs concerning, among other things, future activities or future operating results and various components thereof. Certain statements contained within this MD&A constitute forward-looking statements. The use of any of the words "anticipate", "continue", "expect", "may", "will", "project", "should", "believe", and similar expressions are intended to identify forward looking statements. The expectations, estimates and beliefs contained in such forward-looking statements necessarily involve known and unknown risks and uncertainties which may cause the Fund's actual performance and financial results in future periods to differ materially from any expectations, estimates and beliefs of future performance or results expressed or implied by such forward-looking statements. These risks and uncertainties include, among other things, such risk and uncertainties described in this MD&A. Accordingly, unitholders and potential investors are cautioned that events or circumstances could cause actual results to differ materially from those discussed. K-Bro does not undertake any obligation to publicly revise these forward-looking statements to reflect subsequent events or circumstances.

Critical risks related to K-Bro and the industry

Competitive environment

K-Bro experiences competition in its markets from its public and private sector competitors. The principal elements of competition include quality, service and price. While many competitors are independent and privately owned, certain of K-Bro's competitors are public sector entities and may have greater financial and other resources. There can be no assurance that these competitors will not substantially increase the resources devoted to the development and marketing, including discounting, of products and services that compete with those offered by K-Bro.

In addition to competition provided by its laundry processor competitors, K-Bro also competes against suppliers of single-use disposable linens, particularly in its K-Bro Operating Room ("KOR") business of providing reusable surgical packs. Management estimates that suppliers of disposable packs currently control 80% of the overall market in Canada. In Edmonton, where K-Bro's KOR business is strongest, management believes that KOR has approximately 50% of the surgical pack market, with disposables representing the other half. K-Bro's Edmonton KOR contract is for a two-year term expiring March 31, 2006 and renewal discussions are currently underway. If this contract is not renewed and disposable packs increase their overall market share in Canada, K-Bro's financial results could be negatively impacted.

Acquisitions and integration of acquired businesses

K-Bro's long-term growth strategy depends, in part, on its ability to acquire and successfully integrate and operate additional businesses. There can be no assurances that K-Bro can successfully integrate this new volume or successfully identify, negotiate, complete and integrate any future acquisitions.

Utility costs

K-Bro's operations utilize natural gas, electricity and water that comprise approximately 10% of its operating expenses. K-Bro's energy costs are affected by various market factors including the availability of supplies of particular forms of energy, energy prices and local and national regulatory decisions. There can be no assurance that K-Bro will be protected against substantial changes in the price or availability of energy sources. K-Bro has entered into fixed price natural gas and electricity contracts ranging in duration for 2 to 5 years to fix the price on a significant portion of its natural gas and electricity requirements over this time period. Upon expiration of the contracts, K-Bro will be subject to prevailing market rates.

K-Bro's Calgary and Edmonton facilities currently benefit from a natural gas rebate program sponsored by the Alberta provincial government. The winter rebate program runs from October through March, when gas prices are traditionally highest. During the program, when the price of gas on most Albertans' monthly bills is over $5.50/GJ, rebates are issued. The rebate program is in the final year of a three-year term ending March 31, 2006, and there can be no assurance that the program will be renewed upon its expiry. If the rebate program is not renewed and natural gas prices continue at their present levels, K-Bro's financial results could be negatively impacted.

Relocation of Calgary plant

K-Bro expects to relocate from its Calgary plant upon the expiry of its current lease in 2008. Management currently estimates the costs of any such relocation to be approximately $2 million (assuming a new facility of comparable size and the relocation and installation of existing equipment). Although management expects to relocate in a cost effective manner and to finance any relocation through its cash reserves and/or credit facilities, the costs of relocating could be in excess of this estimate and a new plant more expensive than anticipated could have an adverse effect on K-Bro's business.

Alberta labour market

Alberta currently has the highest employment rate in Canada and on September 1, 2005 the minimum wage was increased by $1.10 per hour. With the high employment and competition in the workplace, K-Bro is faced with a very competitive market for workers and the inability to recruit and retain sufficient workers to process increasing volumes of business could have an adverse impact on the operations. K-Bro has taken steps on many fronts including wage levels, benefits and working conditions to address this situation but there can be no assurance that these will be successful.

British Columbia labour legislation

In 2002, the British Columbia provincial government enacted the Health and Social Services Delivery Improvement Act, which, among other things, voided certain provisions of existing collective agreements between public sector healthcare organizations and their employees. As a result, B.C. healthcare organizations were permitted to contract with outside service providers to perform certain services previously provided by their employees. The enactment of this legislation provided K-Bro with the opportunity to expand its operations by attracting new healthcare customers in the Vancouver region who wished to outsource their linen processing requirements to private sector laundries. Certain healthcare sector unions, associations of bargaining agents and employees affected by this legislation challenged its constitutionality in the B.C. courts but lost their case at both the British Columbia Supreme Court and Court of Appeal levels. These plaintiffs have applied for leave to appeal to the Supreme Court of Canada, and this application is pending. If the Supreme Court of Canada grants the plaintiffs leave to appeal and rules in their favor, there could be a material adverse effect on K-Bro's business, financial condition, liquidity and operating results.

Credit facility imposes numerous covenants and encumbers assets

Covenants in the Credit Facility include, among others, ones that limit the ability of K-Bro to incur additional debt, make liens, dispose of assets, consolidate, merge or acquire other businesses, pay dividends or make other distributions (including on the K-Bro Common Shares and K-Bro Notes held by the Fund), and amend material contracts. These covenants restrict numerous aspects of the business of K-Bro. Moreover, financial performance covenants require K-Bro, among other things, to maintain up to a maximum total debt-to-EBITDA ratio, no less than a minimum ratio of current assets to current liabilities, no less than a minimum interest coverage ratio, and up to a maximum total fixed charge coverage ratio. The failure to comply with the terms of the Credit Facility would entitle the Bank to accelerate all amounts outstanding under the Credit Facility, and upon such acceleration, the Bank would be entitled to begin enforcement procedures against the assets of K-Bro Linen Systems Inc. or the Fund, including accounts receivable, inventory and equipment. The Bank would then be repaid from the proceeds of such enforcement proceedings, using all available assets. Only after such repayment and the payment of any other secured and unsecured creditors would the holders of Units receive any proceeds from the liquidation of K-Bro's assets. K-Bro's ability to satisfy the restrictive covenants may be affected by events beyond its control. K-Bro is in compliance with all bank covenants.

Environmental matters

K-Bro's facilities are subject to federal, provincial and municipal laws and regulations relating to the protection of the environment and worker health and safety including those governing water waste discharges, management, recycling and disposal of hazardous materials and waste, cleanup of contamination, and worker exposure to hazardous materials. K-Bro is attentive to the environmental concerns surrounding and the environmental laws regulating the disposal of its waste materials and has through the years continued to make significant investments in properly handling and disposing of these materials. K-Bro does not use toxic materials or produce hazardous waste in its laundry facilities. All waste water is discharged through the municipal sewer system in compliance with applicable regulations. Each plant's waste water is regularly tested by the relevant municipal authorities to ensure compliance with local by-laws. Compliance with environmental laws and regulations has not and is not expected to give rise, in the aggregate, to any material adverse financial or operational effects upon K-Bro's business. Environmental laws and regulations and their interpretation, however, have changed rapidly over the years and may continue to do so in the future.

Management's Report

Management is responsible for the integrity and objectivity of the financial information presented in this Annual Report. The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The financial information presented elsewhere in this annual report is consistent with that shown in the accompanying consolidated financial statements.

Management maintains a system of internal controls to provide reasonable assurance as to the reliability of financial information and the safeguarding of assets. The consolidated financial statements include amounts that are based on the best estimates of management.

The Board of Trustees is responsible for ensuring management fulfills its responsibilities for financial reporting and internal control. The Board carries out this responsibility principally through its Audit Committee. The Audit Committee, which consists solely of non-management trustees, reviews the consolidated financial statements and recommends them to the Board for approval. The Fund's auditors PricewaterhouseCoopers LLP have full and unrestricted access to the Audit Committee and meet periodically with them (and separately, in the absence of management) to discuss audit, financial reporting, and related matters.

Linda McCurdy
President and Chief Executive Officer

Doug Thomson, CA
VP and Chief Financial Officer

Auditors' Report

February 17, 2006

To the Trustees of K-Bro Linen Income Fund

We have audited the consolidated balance sheet of K-Bro Linen Income Fund as at December 31, 2005 and the consolidated statements of operations and deficit and cash flows for the period then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2005 and the results of its operations and its cash flows for the period then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants
Edmonton, Canada

Consolidated Balance Sheet

As at December 31, 2005

Assets	
Current	
Accounts receivable	$ 5,635,100
Linen in service	6,353,714
Prepaid expenses and deposits	302,959
	12,291,773
Property and equipment (note 4)	15,518,786
Intangible assets (note 5)	18,289,889
Goodwill (note 2)	12,357,766
	58,458,214
Liabilities and unitholders' equity	
Current	
Accounts payable and accrued liabilities	7,190,209
Distributions payable	386,424
Future income taxes (note 8)	1,524,950
	9,101,583
Long-term debt (note 6)	5,401,459
Future income taxes (note 8)	6,338,554
	20,841,596
Contingencies and commitments (note 9)	
Unitholders' equity	
Exchangeable shares (note 10)	724,110
Fund units (note 10)	37,663,425
Deficit	(770,917)
	37,616,618
	58,458,214

Approved on behalf of the Fund:

Ross Smith
Trustee

Matthew Hills
Trustee

Consolidated Statement of Operations and Deficit

For the period February 3, 2005 to December 31, 2005

Revenue	$ 48,101,604
Expenses	
Wages and benefits	21,817,648
Linen	6,503,871
Utilities	3,935,389
Materials and supplies	1,903,689
Occupancy costs	1,781,781
Delivery	1,699,627
Repairs and maintenance	1,307,264
Corporate	1,620,349
Long term incentive plan	418,081
	40,987,699
Earnings before the undernoted	7,113,905
Other income (expenses)	
Amortization of property and equipment	(2,048,332)
Amortization of intangible assets	(1,610,111)
Finance costs (note 7)	(359,798)
Gain on disposal of equipment	63,477
	(3,954,764)
Earnings before income taxes	3,159,141
Income tax (recovery) (note 8)	(293,004)
Net earnings for the period	3,452,145
Deficit – beginning of period	–
Distributions (note 11)	(4,223,062)
Deficit – end of period	(770,917)
Basic and diluted earnings per unit	$ 0.78
Basic and diluted average number of units outstanding	# 4,416,273

Consolidated Statement of Cash Flows

For the period February 3, 2005 to December 31, 2005

Cash provided by (used in)	
Operating activities	
Net earnings for the period	$ 3,452,145
Items not affecting cash	
Amortization of property and equipment	2,048,332
Amortization of intangible assets	1,610,111
Gain on disposal of equipment	(63,477)
Future income taxes	(293,004)
	6,754,107
Net changes in non-cash working capital items (note 12)	363,136
Cash provided by operating activities	7,117,243
Financing activities	
Fund units issued – net of offering costs (note 2)	37,663,425
Exchangeable shares issued	724,110
Distributions paid	(3,836,638)
Decrease in revolving line of credit	(4,420,329)
Cash provided by financing activities	30,130,568
Investing activities	
Acquisition of K-Bro Linen Systems Inc. (note 2)	(35,261,866)
Purchase of property and equipment	(2,645,413)
Proceeds from disposition of equipment	87,030
Cash acquired on acquisition	572,438
Cash used in investing activities	(37,247,811)
Change in cash	–
Cash – beginning of period	–
Cash – end of period	–
Supplementary information	
Interest received	2,211
Interest paid	340,334

Notes to Consolidated Financial Statements

December 31, 2005

1 Business description

K-Bro Linen Income Fund (the "Fund") is a limited purpose trust established under the laws of Alberta pursuant to the Amended and Restated Fund Declaration of Trust dated February 3, 2005. The Fund was created for the purpose of acquiring, directly or indirectly, all of the issued and outstanding securities of K-Bro Linen Systems Inc. K-Bro Linen Systems Inc. provides a range of services to healthcare institutions, hotels and other commercial accounts. These services include the processing, management and distribution of linen.

2 Issuance of Trust Units and acquisition of K-Bro Linen Systems Inc.

On February 3, 2005, the Fund completed its initial public offering (the "Offering") of 4,343,862 Units at a price of $10.00 per Unit for gross proceeds of $43.4 million.

The Fund used the proceeds of the Offering to directly or indirectly pay the expenses of the Offering and to indirectly acquire through a newly formed company ("Newco") all of the issued and outstanding securities of K-Bro Holdco Inc. from the vendor and from the management group for consideration of approximately $32.3 million. Of the cash consideration payable to the vendor and the management group, $3.0 million was deposited into an escrow account with an escrow agent. The funds held in escrow will be released back to the vendor and the management group provided that both earnings before interest, income taxes, depreciation and amortization and distribution targets are met congruently for any given fiscal year. Management has determined that these criteria have been met for fiscal 2005 and consequently, upon approval by the Trustees, the funds held in escrow will be released back to the vendor and the management group. Goodwill has correspondingly been increased by $3.0 million from the amount initially recorded at February 3, 2005. Interest on escrow funds is accrued for the benefit of the vendor and the management group.

Also on February 3, 2005, Newco, K-Bro Holdco Inc. and its directly and indirectly owned subsidiaries, K-Bro Linen Systems Inc. and K-Bro Linen Systems (Ontario) Limited, amalgamated pursuant to the laws of Alberta to form Amalco, which was named K-Bro Linen Systems Inc.

Newco used the proceeds of the Offering, net of the Offering costs borne directly by the Fund and the cash purchase price paid for the outstanding securities of K-Bro Holdco Inc. as described above, to:

a) pay the remaining expenses of the Offering;

b) repay $3.1 million of the existing credit facilities of K-Bro Linen Systems Inc.; and

c) make a cash payment of approximately $2.0 million (net of exchangeable shares of $0.7 million) to the management security holders pursuant to a management incentive plan, that resulted in the settlement of amounts payable for stock appreciation rights and bonuses for other members of management.

The acquisition of K-Bro Linen Systems Inc. was accounted for using the purchase method and, accordingly, the results of operations from February 3, 2005 have been included in these consolidated financial statements. The consideration paid has been allocated to the assets acquired based on their fair values as follows:

2 Issuance of Trust Units and acquisition of K-Bro Linen Systems Inc. (continued)

Consideration	
Cash from Offering (net of Offering costs)	$ 37,663,425
Repayment of credit facilities	(3,125,669)
	34,537,756
Issuance of exchangeable shares	724,110
	35,261,866
Net assets acquired	
Cash	572,438
Accounts receivable	4,645,795
Linen in service	6,043,236
Prepaid expenses and deposits	319,665
Intangible assets	19,900,000
Property and equipment	14,945,258
Goodwill	12,357,766
Accounts payable and accrued liabilities	(5,543,996)
Long-term debt	(9,821,788)
Future income taxes	(8,156,508)
	35,261,866

3 Significant accounting policies

The consolidated financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada. The precise determination of many assets and liabilities is dependent upon future events. Accordingly, the preparation of financial statements for a reporting period necessarily involves the use of estimates and approximations which have been made using careful judgment. Actual results could differ from those estimates. The consolidated financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the accounting policies summarized below.

a) Basis of presentation

The consolidated financial statements include the Fund and its wholly owned subsidiary, K-Bro Linen Systems Inc. All material intercompany balances and transactions have been eliminated upon consolidation. The consolidated financial statements are for the period from February 3, 2005, the date of commencement of operations, to December 31, 2005 inclusive, and accordingly, no comparative information is provided.

b) Linen in service

Linen in service is recorded at cost. Operating room linen is amortized on a straight-line method over the estimated service life of 24 months. General linen is amortized based on usage which results in an estimated average service life of the linen equal to 24 months.

3 Significant accounting policies (continued)

c) Revenue recognition

Revenue from linen management and laundry services is largely based on written service agreements whereby the Fund agrees to collect, launder, deliver and replenish linens. The Fund recognizes revenue in the period in which the services are provided.

d) Property and equipment

Property and equipment are recorded at cost. Amortization is provided over the estimated useful lives of the asset using the following annual rates and methods:

Laundry equipment	15%
Office and delivery equipment	20%
Computers and software	30%
Leasehold improvements	Straight-line over the lease period

e) Intangible assets

Intangible assets with a finite life, which relate to contracts the Fund has with certain customers, are recorded at cost and are amortized over the remaining life of the contract plus one renewal period, ranging from 49 months to 205 months.

f) Impairment of long-lived assets

The Fund assesses impairment of its long-lived assets (property and equipment and intangible assets) when events or changes in circumstances cause the carrying value of an asset to exceed the total undiscounted cash flows expected from its use and eventual disposition. An impairment loss, if any, is determined as the excess of the carrying value of the assets over its fair value.

g) Future income taxes

The incorporated subsidiary of the Fund calculates income taxes using the liability method of accounting. Temporary differences arising from the difference between the tax basis of an asset or liability and its carrying amount on the balance sheet are used to calculate future income tax liabilities or assets. Future income tax liabilities or assets are calculated using tax rates anticipated to apply in periods that the temporary differences are expected to reverse. The effect on future income tax assets or liabilities is recognized in income in the period that the change occurs.

Income tax obligations relating to distributions of the Fund are the obligations of the Unitholders and, accordingly, no provision for income taxes has been made in respect of the assets and liabilities of the Fund.

h) Goodwill

Goodwill represents the excess of the cost of business acquisitions over the fair value of net identifiable assets acquired. Goodwill is not amortized but is tested for impairment annually or more frequently if changes in circumstances indicate a potential impairment.

3 Significant accounting policies (continued)

i) Volume rebates

Certain customers receive a rebate based on specified annual processing volumes. A volume rebate liability is recognized at the time it is expected that the customer will meet the specified annual volume levels.

j) Financial instruments

The Fund's financial instruments consists of derivative financial instruments, distributions payable, accounts receivable, accounts payable and accrued liabilities and long-term debt. Unless otherwise stated, the fair value of the financial instruments approximates their carrying value.

k) Derivative financial instruments

The Fund has adopted CICA Accounting Guideline 13, Hedging Relationships. This pronouncement establishes the criteria that must be met before an entity can apply hedge accounting to certain derivative financial instruments.

Derivative financial instruments are utilized by the Fund to manage cash flow risk against the volatility in interest rates on its long-term debt and foreign exchange fluctuations on its equipment purchase commitments. The Fund does not utilize derivative financial instruments for trading or speculative purposes.

The Fund has floating interest rate debt that gives rise to risks that its earnings and cash flows may be adversely impacted by fluctuations in interest rates. In order to manage this risk, the Fund may enter into interest rate swaps, forward contracts or option contracts.

It is the Fund's policy to document all relationships between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedge transactions. This process includes linking all derivatives to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. The Fund also assesses, both at the hedge inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are effective in offsetting changes in fair value or cash flows of hedged items. The Fund's interest rate swaps, forward contracts or option contracts are designated as hedges when the underlying risks of the hedged and hedging instruments offset to manage the Fund's exposure. Gains or losses relating to such contracts are deferred and recognized in the same period and financial statement category as the corresponding hedged transaction. If contracts cease to be effective as hedges prior to maturity or if the hedge relationship is terminated, any cumulative gains or losses arising prior to such time will be deferred over the period of the original hedged transaction and subsequent changes in fair value of the derivative contracts are recognized as adjustments to income.

l) Earnings per unit

Earnings per unit is calculated by dividing the earnings attributable to each unit by the weighted average units outstanding. Diluted earnings per unit is calculated using the treasury stock method. For the current period, the weighted-average units outstanding and the weighted-average diluted units outstanding are identical.

4 Property and equipment

			2005
	Cost	Accumulated amortization	Net
Equipment			
Laundry	$ 12,106,690	$ 1,497,512	$ 10,609,178
Office	188,736	29,859	158,877
Delivery	207,103	34,958	172,145
Computers and software	632,021	135,141	496,880
Leasehold improvements	2,994,940	350,862	2,644,078
Deposits on equipment purchases (note 9)	1,437,628	–	1,437,628
	17,567,118	2,048,332	15,518,786

5 Intangible assets

			2005
	Cost	Accumulated amortization	Net
Finite life intangible assets			
Healthcare contracts	$ 15,700,000	$ 1,034,104	$ 14,665,896
Operating room contracts	3,500,000	447,674	3,052,326
Hospitality contracts	700,000	128,333	571,667
	19,900,000	1,610,111	18,289,889

6 Long-term debt

On February 3, 2005, in conjunction with the initial public offering described in note 2, K-Bro Linen Systems Inc. secured a revolving credit facility of up to $12,000,000 of which $5,836,459 is drawn (including letters of credit per note 9). The facility is a two-year committed facility maturing February 3, 2007 extendable annually for another year at the lender's option. Interest payments only are due during the term of the facility.

A general security agreement over all assets, a mortgage against all leasehold interests, insurance policies and an assignment of material agreements have been pledged as collateral.

Drawings under the revolving credit facility are available by way of Bankers' Acceptances, Canadian prime rate loans, letters of credit or standby letters of guarantee. Drawings under the revolving credit facility bear interest at a floating rate, plus an applicable margin based on certain financial performance ratios. For Bankers' Acceptances the margin will vary from 2.00% to 2.75%, for Canadian prime rate loans, the margin will vary from 0.50% to 1.25%.

The balance consists of:	
Bankers' acceptances, 5.33%	$ 4,000,000
Prime rate loan, 5.50%	1,401,459
	5,401,459

7 Finance costs

Interest on long-term debt	$	340,334
Bank and service charges, net		19,464
		359,798

8 Income taxes

Future	$	(293,004)

A reconciliation of the expected income tax expense to the actual income tax expense is as follows:

Canadian statutory rates (federal and provincial)	34.4%
Expected provision for income taxes	1,086,745
Increase (decrease) from	
Non-deductible items	14,417
Difference between statutory and future income tax rates and other	(89,345)
Income of the Fund allocated to unitholders	(1,304,821)
Actual provision for income taxes	(293,004)

Income tax refund received for the period ended December 31, 2005 was $10,333.

Future income taxes have been provided as follows:

Linen in service	$	1,685,279
Accounts payable and accrued liabilities		(160,329)
		1,524,950
Property and equipment		1,202,630
Intangible assets		6,264,742
Offering costs and other		(1,128,848)
		6,338,524
		7,863,474

The benefit of deductible temporary differences of $1,200,000 relating to offering costs borne directly by the Fund have not been recorded.

9 Contingencies and commitments

a) Contingencies

Letters of credit

The Fund has outstanding letters of credit issued as part of normal business operations in the amounts of $185,000 (expiring January 21, 2006 but to be renewed for a further year) and $250,000 (expiring January 24, 2006 but to be renewed for a further year).

b) Commitments

Operating leases and utility commitments

Minimum lease payments for operating leases on buildings and equipment and estimated natural gas and electricity commitments for the next five calendar years are as follows:

2006	$ 3,905,590
2007	3,905,016
2008	3,107,624
2009	2,925,823
2010	1,474,645
Subsequent	2,703,831

Included above are fixed rate electricity purchase commitments for two to five years entered into on November 29, 2005 with an effective date of February 1, 2006.

Linen commitments

At December 31, 2005, the Fund was committed to linen expenditure obligations in the amount of $3,228,307.

Equipment purchase commitments

The Fund has commitments to purchase equipment totalling $ 5,676,000 at December 31, 2005. These commitments are with respect to the $6.4 million strategic capital expenditure program as announced. Deposits of $1,437,628 with respect to these purchases are included in property and equipment.

10 Unitholders' equity

a) Authorized

The declaration of trust provides that an unlimited number of units and an unlimited number of Special Trust Units may be issued.

b) Issued and outstanding

Fund units				
Issued on initial public offering	#	4,343,862	$	43,438,620
Offering costs				(5,775,195)
				37,663,425
Exchangeable shares	#	72,411	$	724,110

The exchangeable shares were issued by the Fund's subsidiary to certain members of management and are exchangeable on a one-to-one basis for Fund Units. The risks and privileges of these shares are the same as for Fund Units.

The exchangeable shares of the Fund's subsidiary are synonymous with the Special Trust Units of the Fund.

11 Accumulated distributions declared

Distributions are declared payable each month to the Fund unitholders and exchangeable shareholders on the last business day of each month and are paid the 15th of the following month. Distributions declared during the period ended December 31, 2005, are as follows:

Period		Per Unit		Amount
Fund Units				
February 3 – February 28, 2005	$	0.08125	$	352,940
March 1 – December 31, 2005		0.08750		3,800,880
Exchangeable shares				
February 3 – February 28, 2005		0.08125		5,882
March 1 – December 31, 2005		0.08750		63,360
				4,223,062

12 Net changes in non-cash working capital items

Cash provided (used) by changes in	
Accounts receivable	$ (989,305)
Linen in service	(310,478)
Prepaid expenses and deposits	16,706
Accounts payable and accrued liabilities	1,646,213
	363,136

13 Financial instruments

Fair value

The carrying value of accounts receivable, and accounts payable and accrued liabilities approximate fair value due to the immediate or short-term maturity of these financial instruments. The fair value of the Fund's long-term debt is estimated based on market prices for same or similar instruments and approximates carrying value.

Interest rate swap agreement

The Fund entered into an interest rate swap agreement on June 24, 2005 through its Canadian chartered bank to fix the interest rate on a portion of its debt by exchanging a notional amount of $4,000,000 of existing debt from a floating rate to a fixed interest rate for five years at 5.95%. The difference between the amounts paid and received is accrued and accounted for as an adjustment to interest expense. The unrecorded fair value of the interest rate swap at December 31, 2005 was $29,598.

Foreign exchange contracts

The Fund has entered into foreign exchange contracts through its Canadian chartered bank to hedge its foreign denominated equipment purchase commitments (see note 9). At December 31, 2005, foreign exchange contracts were outstanding to purchase $2.25 million US at an average rate of 1.1549 and 0.4 million Euros at an average rate of 1.3862 during the period ending May 31, 2006. The unrecorded fair value of the foreign exchange contracts at December 31, 2005 was $11,132.

Credit risk

The Fund is exposed to credit risk in the event of non-performance by customers, but does not anticipate such non-performance due to the nature of its customers. The maximum credit risk is the fair value of the accounts receivable.

14 Segmented information

The Fund provides laundry and linen services to the healthcare and hospitality sectors through four operating segments in Vancouver, Calgary, Edmonton and Toronto. The services offered and the economic characteristics associated with these segments are similar, therefore these segments have been aggregated into one reportable segment which operates exclusively in Canada.

Total revenue derived from the healthcare and hospitality sectors are as follows:

Healthcare	$ 40,144,573	83.5%
Hospitality	7,957,031	16.5
Total	48,101,604	100.0

In Edmonton, the Fund is the significant supplier of laundry and linen services to the entity which manages all major healthcare facilities in the region. This contract expires on December 31, 2010. In Calgary, the major customer is contractually committed to February 28, 2008 and in Vancouver the major customer is contractually committed to January 15, 2013.

For the period from February 3, 2005 to December 31, 2005, the company has recorded revenue of $31.4 million from these three major customers, representing 65% of total revenue.

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Trading Symbol, Toronto Stock Exchange
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Doug Thomson, C.A.
Vice President and Chief Financial Officer

Jerry Ostrzyzek
Vice President Eastern Operations & General Manager

Ron Graham
General Manager, Vancouver

Jeff Gannon
General Manager, Calgary

Annual General Meeting
The Annual General Meeting of the Unitholders will be held in the Gallery room at the TSX Broadcast & Conference Centre, The Exchange Tower, 130 King Street West, Toronto on Tuesday, June 13, 2006 at 2 o'clock in the afternoon. All Unitholders are cordially invited to attend the meeting and informal reception following.

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